

Auditing Procedures Report

Issued under P.A. 2 of 1968, as amended and P.A. 71 of 1919, as amended.

Local Unit of Government Type <input type="checkbox"/> County <input checked="" type="checkbox"/> City <input type="checkbox"/> Twp <input type="checkbox"/> Village <input type="checkbox"/> Other		Local Unit Name City of Montrose	County Genesee
Fiscal Year End 6/30/06	Opinion Date 9/28/06	Date Audit Report Submitted to State 11/29/06	

We affirm that:

We are certified public accountants licensed to practice in Michigan.

We further affirm the following material, "no" responses have been disclosed in the financial statements, including the notes, or in the Management Letter (report of comments and recommendations).

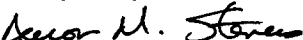
50
2

Check each applicable box below. (See instructions for further detail.)

1. ☒ ☐ All required component units/funds/agencies of the local unit are included in the financial statements and/or disclosed in the reporting entity notes to the financial statements as necessary.
2. ☒ ☐ There are no accumulated deficits in one or more of this unit's unreserved fund balances/unrestricted net assets (P.A. 275 of 1980) or the local unit has not exceeded its budget for expenditures.
3. ☒ ☐ The local unit is in compliance with the Uniform Chart of Accounts issued by the Department of Treasury.
4. ☒ ☐ The local unit has adopted a budget for all required funds.
5. ☒ ☐ A public hearing on the budget was held in accordance with State statute.
6. ☒ ☐ The local unit has not violated the Municipal Finance Act, an order issued under the Emergency Municipal Loan Act, or other guidance as issued by the Local Audit and Finance Division.
7. ☒ ☐ The local unit has not been delinquent in distributing tax revenues that were collected for another taxing unit.
8. ☒ ☐ The local unit only holds deposits/investments that comply with statutory requirements.
9. ☒ ☐ The local unit has no illegal or unauthorized expenditures that came to our attention as defined in the *Bulletin for Audits of Local Units of Government in Michigan*, as revised (see Appendix H of Bulletin).
10. ☒ ☐ There are no indications of defalcation, fraud or embezzlement, which came to our attention during the course of our audit that have not been previously communicated to the Local Audit and Finance Division (LAFD). If there is such activity that has not been communicated, please submit a separate report under separate cover.
11. ☒ ☐ The local unit is free of repeated comments from previous years.
12. ☒ ☐ The audit opinion is UNQUALIFIED.
13. ☒ ☐ The local unit has complied with GASB 34 or GASB 34 as modified by MCGAA Statement #7 and other generally accepted accounting principles (GAAP).
14. ☒ ☐ The board or council approves all invoices prior to payment as required by charter or statute.
15. ☒ ☐ To our knowledge, bank reconciliations that were reviewed were performed timely.

If a local unit of government (authorities and commissions included) is operating within the boundaries of the audited entity and is not included in this or any other audit report, nor do they obtain a stand-alone audit, please enclose the name(s), address(es), and a description(s) of the authority and/or commission.

I, the undersigned, certify that this statement is complete and accurate in all respects.

We have enclosed the following:	Enclosed	Not Required (enter a brief justification)	
Financial Statements	<input checked="" type="checkbox"/>		
The letter of Comments and Recommendations	<input checked="" type="checkbox"/>	N/A	
Other (Describe)	<input checked="" type="checkbox"/>	N/A	
Certified Public Accountant (Firm Name) Abraham & Gaffney, P.C.		Telephone Number (517) 351-6836	
Street Address 3511 Coolidge Road, Suite 100		City East Lansing	State MI
		Zip 48823	
Authorizing CPA Signature 	Printed Name Aaron M. Stevens, CPA		License Number 1101024055

**City of Montrose
Genesee County, Michigan**

FINANCIAL STATEMENTS

June 30, 2006

City of Montrose
Genesee County, Michigan
CITY COUNCIL
June 30, 2006

Eldon Dunklee	Mayor
Deborah Gross	Mayor Pro-Tem
Frank DeForke	Council Member
Norville Landes	Council Member
Gene Powell	Council Member
Candy LaMay	Council Member
Scott Parks	Council Member

City of Montrose
Genesee County, Michigan

TABLE OF CONTENTS

June 30, 2006

	<u>Page</u>
INDEPENDENT AUDITOR'S REPORT	i
MANAGEMENT'S DISCUSSION AND ANALYSIS	ii-x
BASIC FINANCIAL STATEMENTS	
Government-wide Financial Statements	
Statement of Net Assets	1
Statement of Activities	2
Fund Financial Statements	
Governmental Funds Balance Sheet	3-4
Reconciliation of the Governmental Funds Balance Sheet to the Statement of Net Assets	5
Statement of Revenues, Expenditures, and Changes in Fund Balance - Governmental Funds	6-7
Reconciliation of the Statement of Revenues, Expenditures, and Changes in Fund Balances of Governmental Funds to the Statement of Activities	8
Statement of Net Assets - Proprietary Funds	9
Statement of Revenues, Expenses, and Changes in Fund Net Assets - Proprietary Funds	10
Statement of Cash Flows - Proprietary Funds	11
Statement of Net Assets - Fiduciary Funds	12
Notes to Financial Statements	13-27
REQUIRED SUPPLEMENTARY INFORMATION	
GENERAL FUND	
Budgetary Comparison Schedule	28-30
SPECIAL REVENUE FUNDS	
Local Street Fund - Budgetary Comparison Schedule	31
OTHER SUPPLEMENTARY INFORMATION	
Combining Balance Sheet - Nonmajor Governmental Funds	32-33
Combining Statement of Revenues, Expenditures, and Changes in Fund Balances - Nonmajor Governmental Funds	34-35
COMPONENT UNIT FUND	
DOWNTOWN DEVELOPMENT AUTHORITY	
Balance Sheet	36
Reconciliation of the Governmental Fund Balance Sheet to the Statement of Net Assets	37
Statement of Revenues, Expenditures and Changes in Fund Balance	38
Reconciliation of the Statement of Revenue, Expenditures and Change in Fund Balance of the Governmental Fund to the Statement of Activities	39

Principals

Dale J. Abraham, CPA
Michael T. Gaffney, CPA
Steven R. Kirinovic, CPA
Aaron M. Stevens, CPA
Eric J. Glashouwer, CPA



ABRAHAM & GAFFNEY, P.C.
Certified Public Accountants

3511 Coolidge Road
Suite 100
East Lansing, MI 48823
(517) 351-6836
FAX: (517) 351-6837

INDEPENDENT AUDITOR'S REPORT

To the Honorable Mayor and
Members of the City Council
City of Montrose
Montrose, Michigan

We have audited the accompanying financial statements of the governmental activities, the business-type activities, the discretely presented component unit, each major fund, and the aggregate remaining fund information of the City of Montrose, Michigan as of and for the year ended June 30, 2006, which collectively comprise the City's basic financial statements as listed in the table of contents. These financial statements are the responsibility of City of Montrose's management. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

In our opinion, based on our audit the financial statements referred to above present fairly, in all material respects, the financial position of the governmental activities, the business-type activities, the discretely presented component unit, each major fund, and the aggregate remaining fund information of the City of Montrose, Michigan as of June 30, 2006, and the respective changes in financial position and cash flows, where applicable, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The management's discussion and analysis and budgetary comparison information as identified in the table of contents are not a required part of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was made for the purpose of forming opinions on the financial statements that collectively comprise the City of Montrose's basic financial statements. The accompanying other supplementary information, as identified in the table of contents, is presented for the purpose of additional analysis and is not a required part of the basic financial statements. The other supplementary information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Abraham & Gaffney, P.C.

ABRAHAM & GAFFNEY, P.C.
Certified Public Accountants

September 28, 2006

MANAGEMENT'S DISCUSSION AND ANALYSIS

June 30, 2006

The following is a discussion and analysis of City of Montrose's (the City's) financial performance and position, providing an overview of the activities for the year ended June 30, 2006. This analysis should be read in conjunction with the *Independent Auditors Report* and with the City's financial statements, which follow this section.

FINANCIAL HIGHLIGHTS

Government-wide:

- Total net assets were \$4,188,077 (excluding component units).
- Governmental activities net assets were \$1,318,305.
- Business-type activity net assets were \$2,869,772.
- Component Unit net assets were \$173,340.

Fund Level:

- At the close of the fiscal year, the City's governmental funds reported a combined ending fund balance of \$1,049,530 with \$557,781 being reserved, designated, or otherwise earmarked for specific purposes (capital projects, debt service).
- The General Fund realized \$9,627 less in revenues and other financing sources than anticipated for the fiscal year. The General Fund operations expended \$10,807 less than appropriated.
- Overall, the General Fund balance increased by \$3,340 to \$202,325 - of which \$147,759 is undesignated and available for general purposes.

Capital and Long-term Debt Activities:

- The primary government had one (1) new debt issue for the fiscal year in the form of Limited General Obligation Bonds \$405,000. The \$405,000 bond issue financed substantial infrastructure improvements in the City's downtown district, including installing larger water lines with new hydrants, paving the gravel alleys and parking lot area, and constructing a storm water management system that will protect both private and public real properties from potential storm water damages in the future.
- The total long-term debt for the primary government was \$1,932,060, an increase of \$315,213 from the prior year.
- The City remains well below its authorized legal debt limit.
- The total additions to the capital asset schedule for the primary government were \$1,058,805 and included improvements to the City's storm drain system and the construction of the Orchard Street Storm Drains, which is in progress.

OVERVIEW OF THE FINANCIAL STATEMENTS

This discussion and analysis is intended to serve as an introduction to the City's annual financial report. The annual financial report of the City consists of the following components: 1) *Independent Auditor's Report*; 2) *Management's Discussion and Analysis* and 3) the *Basic Financial Statements* (government-wide financial statements, fund financial statements, notes to the financial statements), 4) *Required Supplementary Information* such as budget to actual comparisons for the General Fund and major Special Revenue Funds, and 5) *Other Supplementary Information* including combining financial statements for all nonmajor governmental funds and other funds and other financial data.

MANAGEMENT'S DISCUSSION AND ANALYSIS

June 30, 2006

Government-wide Financial Statements (Reporting the City as a Whole)

The set of government-wide financial statements are made up of the Statement of Net Assets and the Statement of Activities, which report information about the City as a whole, and about its activities. Their purpose is to assist in answering the question, is the City, in its entirety, better or worse off as a result of this fiscal year's activities? These statements, which include all nonfiduciary assets and liabilities, are reported on the *accrual basis of accounting*, similar to a private business. This means revenues are accounted for when they are *earned* and expenses are accounted for when *incurred*, regardless of when the actual cash is received or disbursed.

The Statement of Net Assets (page 1) presents all of the City's assets and liabilities, recording the difference between the two as "net assets". Over time, increases or decreases in net assets measure whether the City's financial position is improving or deteriorating.

The Statement of Activities (page 2) presents information showing how the City's net assets changed during 2005/2006. All changes in net assets are reported based on the period for which the underlying events giving rise to the change occurs, regardless of the timing of related cash flows. Therefore, revenue and expenses are reported in these statements for some items that will only result in cash flows in future financial periods, such as uncollected taxes and earned but unused employee vacation leave.

Both statements report the following activities:

- **Governmental Activities** - Most of the City's basic services are reported under this category. Taxes, charges for services and intergovernmental revenue primarily fund these services. Most of the City's general government departments, public safety, public works, economic development, city improvements, recreation activities, and other City wide elected official operations are reported under these activities.
- **Business-type Activities** - These activities operate like private businesses. The City charges fees to recover the cost of the services provided. The Sewer System and Water System are examples of these activities.
- **Discretely Presented Component Unit** - The discretely presented component unit (Downtown Development Authority) is a legally separate organization for which the City Council and Administration appoints a majority of the organization's policy board and there is a degree of financial accountability to the City.

As stated previously, the government-wide statements report on an *accrual* basis of accounting. However, the governmental funds report on a *modified accrual* basis. Under modified accrual accounting, revenues are recognized when they are measurable and available to pay obligations of the fiscal period; expenditures are recognized when they are due to be paid from available resources.

Because of the different basis of accounting between the fund statements (described below) and the government-wide statements, pages 5 and 8 present reconciliations between the two statement types. The following summarizes the impact of transitioning from modified accrual to full accrual accounting:

- Capital assets used in governmental activities (depreciation) are not reported on the fund financial statements of the governmental fund. Capital assets and depreciation expense are reported on the government-wide statements.
- Capital outlay spending results in capital assets on the government-wide statements, but is reported as expenditures on the fund financial statements of the governmental funds.
- Long-term liabilities, such as amounts accrued for sick and annual leave (compensated absences), etc. appear as liabilities on the government-wide statements; however they will not appear on the fund financial statements unless current resources are used to pay a specific obligation.
- Long-term debt proceeds are reported as liabilities on the government-wide statements, but are recorded as other financing sources on the fund financial statements.

MANAGEMENT'S DISCUSSION AND ANALYSIS

June 30, 2006

Fund Financial Statements (Reporting the City's Major Funds)

The fund financial statements, which begin on page 3, provide information on the City's significant (major) funds, and aggregated nonmajor funds. A fund is a fiscal and accounting entity with a self-balancing set of accounts that the City uses to keep track of specific sources of funding and spending for a particular purpose. Traditional users of governmental financial statements will find the Fund Financial Statements presentation more familiar.

The *basic financial statements* report major funds as defined by the Government Accounting Standards Board (GASB) in separate columns. Statement 34 defines a "major fund" as the General Fund, and any governmental or enterprise fund which has either total assets, total liabilities, total revenues or total expenditures/expenses that equal at least ten (10) percent of those categories for either the governmental funds or the enterprise funds and where the individual fund total also exceeds five (5) percent of those categories for governmental and enterprise funds combined. The major funds for City of Montrose include the General Fund, the Local Street Fund, the Capital Projects Fund, the Downtown Projects Fund, the Sewer System Fund and the Water System Fund. All other funds are classified as nonmajor funds and are reported in aggregate by the applicable fund type.

The City's funds are divided into three categories - governmental, proprietary, and fiduciary - and use different accounting approaches:

- **Governmental Funds** - Most of the City's basic services are reported in the governmental funds. The focus of these funds is how cash and other financial assets that can be readily converted to cash, flow in and out during the course of the fiscal year and how the balances left at year-end are available for spending on future services. Consequently, the governmental fund financial statements provide a detailed short-term view that helps determine whether there are more or fewer financial resources that may be expended in the near future to finance the City's programs. Governmental funds include the *General Fund*, as well as *Special Revenue Funds* (use of fund balance is restricted, e.g. major street, local street, and depot funds), *Capital Projects Funds* (used to report major capital acquisitions and construction, e.g. the Capital Projects Fund), and *Debt Service Funds* (accounts for resources used to pay long-term debt principal and interest e.g. voted bonds and non-voted bonds funds).
- **Proprietary Funds** - Services for which the City charges customers (whether outside the City structure or a City department) a fee are generally reported in proprietary funds. Proprietary funds use the same *accrual* basis of accounting used in the government-wide statements and by private business. There are two types of proprietary funds. *Enterprise funds* report activities that provide supplies and/or services to the general public. An example is the Sewer System Fund.
- **Fiduciary Funds** - The City may act as a trustee or fiduciary in certain instances. It is also responsible for other assets that, because of trust arrangements, can only be used for the trust beneficiaries. The City's fiduciary activities are reported in the separate Statement of Net Assets on page 12. These funds, which include trust and agency funds, are reported using the accrual basis of accounting. The government-wide statements *exclude* the fiduciary fund activities and balances because these assets are not available to the City to fund its operations.

Notes to the Financial Statements

The Notes to the Financial Statements provide additional information that is essential to a full understanding of the detail provided in the government-wide and fund financial statements. The Notes can be found beginning on page 13 of this report.

Required Supplementary Information

Following the Basic Financial Statements is additional Required Supplementary Information (RSI), which further explains and supports the information in the financial statements. RSI includes budgetary comparison schedules for the General Fund and the major special revenue funds.

City of Montrose

MANAGEMENT'S DISCUSSION AND ANALYSIS

June 30, 2006

Other Supplementary Information

Other Supplementary Information includes combining financial statements for nonmajor governmental funds. These funds are added together and are presented in aggregate single columns in the appropriate basic financial statements.

FINANCIAL ANALYSIS OF THE CITY AS A WHOLE

As previously stated, City of Montrose combined net assets were \$4,188,077 at the end of this fiscal year's operations. The net assets of the governmental activities were \$1,318,305; the business-type activities were \$2,869,772.

Net Assets as of June 30, 2005 and 2006

	Governmental Activities		Business-type Activities		Total Primary Government	
	<u>2005</u>	<u>2006</u>	<u>2005</u>	<u>2006</u>	<u>2005</u>	<u>2006</u>
Current and Other Assets	\$ 1,341,875	\$ 1,279,950	\$ 1,786,301	\$ 1,490,564	\$ 3,128,176	\$ 2,770,514
Capital Assets	<u>724,332</u>	<u>1,320,492</u>	<u>1,909,294</u>	<u>2,235,902</u>	<u>2,633,626</u>	<u>3,556,394</u>
Total Assets	<u>\$ 2,066,207</u>	<u>\$ 2,600,442</u>	<u>\$ 3,695,595</u>	<u>\$ 3,726,466</u>	<u>\$ 5,761,802</u>	<u>\$ 6,326,908</u>
Current Liabilities	\$ 111,647	\$ 172,328	\$ 95,450	\$ 136,780	\$ 207,097	\$ 309,108
Noncurrent Liabilities	<u>779,234</u>	<u>1,109,809</u>	<u>754,194</u>	<u>719,914</u>	<u>1,533,428</u>	<u>1,829,723</u>
Total Liabilities	<u>\$ 890,881</u>	<u>\$ 1,282,137</u>	<u>\$ 849,644</u>	<u>\$ 856,694</u>	<u>\$ 1,740,525</u>	<u>\$ 2,138,831</u>
Net Assets						
Invested in Capital Assets (Net of related debt)	\$ 643,384	\$ 149,833	\$ 1,129,294	\$ 1,490,902	\$ 1,772,678	\$ 1,640,735
Restricted	972,169	830,041	67,059	70,392	1,039,228	900,433
Unrestricted	<u>(440,227)</u>	<u>338,431</u>	<u>1,649,598</u>	<u>1,308,478</u>	<u>1,209,371</u>	<u>1,646,909</u>
Total Net Assets	<u>\$ 1,175,326</u>	<u>\$ 1,318,305</u>	<u>\$ 2,845,951</u>	<u>\$ 2,869,772</u>	<u>\$ 4,021,277</u>	<u>\$ 4,188,077</u>

The following condensed financial information was derived from the government-wide Statement of Activities and reflects how the City's primary government net assets changed during the fiscal year:

City of Montrose

MANAGEMENT'S DISCUSSION AND ANALYSIS

June 30, 2006

Changes in Net Assets for the Fiscal Year Ending June 30, 2005 and 2006

	Governmental Activities		Business-type Activities		Total	
	<u>2005</u>	<u>2006</u>	<u>2005</u>	<u>2006</u>	<u>2005</u>	<u>2006</u>
Revenues						
Program Revenues						
Charges for Services	\$ 142,438	\$ 212,452	\$ 554,764	\$ 576,829	\$ 697,202	\$ 789,281
Grants and Contributions	112,625	203,008	81,417	78,084	194,042	281,092
General Revenues						
Property Taxes	402,583	402,946	-	-	402,583	402,946
State Shared Revenue	194,393	191,875	-	-	194,393	191,875
Investment Earnings	7,279	13,016	24,180	41,784	31,459	54,800
Miscellaneous	38,817	50,943	194	624	39,011	51,567
Transfers	<u>485,600</u>	<u>-</u>	<u>(485,600)</u>	<u>-</u>	<u>-0-</u>	<u>-0-</u>
Total Revenues	1,383,735	1,074,240	174,955	697,321	1,558,690	1,771,561
Expenses						
General Govt.	324,654	371,345	-	-	324,654	371,345
Public Safety	269,477	274,446	-	-	269,477	274,446
Public Works	265,332	216,112	-	-	265,332	216,112
Community and Economic Develop.	42,366	13,640	-	-	42,366	13,640
Recreation and Cultural	15,390	19,713	-	-	15,390	19,713
Other	<u>5,940</u>	<u>36,005</u>	<u>544,176</u>	<u>673,500</u>	<u>550,116</u>	<u>709,505</u>
Total Expenses	<u>923,159</u>	<u>931,261</u>	<u>544,176</u>	<u>673,500</u>	<u>1,467,335</u>	<u>1,604,761</u>
Increase in Net Assets	460,576	142,979	(369,221)	23,821	91,355	166,800
Net Assets - Beginning	706,893	1,175,326	3,215,172	2,845,951	3,922,065	4,021,277
Prior Period Adjustment	<u>7,857</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>7,857</u>	<u>-</u>
Net Assets - Ending	<u>\$ 1,175,326</u>	<u>\$ 1,318,305</u>	<u>\$ 2,845,951</u>	<u>\$ 2,869,772</u>	<u>\$ 4,021,277</u>	<u>\$ 4,188,077</u>

Governmental Activities:

The result of 2005/2006 governmental activity was an increase of \$142,979 in net assets to \$1,318,305. Of the total governmental activities' net assets, \$149,833 is invested in capital assets less related debt, \$830,041 is reported as restricted, meaning these assets are legally committed for a specific purpose through statute, or by another authority outside the City government. The balance of \$338,431 is listed as unrestricted.

City of Montrose

MANAGEMENT'S DISCUSSION AND ANALYSIS

June 30, 2006

Revenues:

The three largest revenue categories were property taxes at 37.5%, charges for services at 19.8%, and grant and contributions at 18.9%. The City levied a property tax millage for the year ended June 30, 2006, for general government operations at 17.4004 mills, which is not assigned to any particular activity. Charges for services and grants and contributions revenue, the second and third largest sources of governmental activity revenue, are assigned to particular functional activities.

Expenses:

General government is the largest governmental activity, expending approximately 39.9% of the governmental activities total and includes general government departments (e.g., council, community promotions, city manager, elections, general administration, assessor, city hall maintenance, and cemetery operations). Public Safety is the second largest area, expending approximately 29.5% of the governmental activities total on law enforcement, fire protection and code enforcement. Public Works expended approximately 23.2% of the governmental activities total and would be higher if capital outlay charged to this function in the funds were not shown as capital assets in the government-wide financial statements.

Business-type Activities:

Net assets in business-type activities increased by \$23,821 during fiscal year 2005/2006. Of the business-type activities' net assets, \$1,490,902 is invested in capital assets net of related debt; \$70,392 is reported as restricted, meaning these assets are legally committed for a specific purpose through statute or by another authority outside the City government, and the balance of \$1,308,478 is listed as unrestricted, having no legal commitment.

FINANCIAL ANALYSIS OF THE CITY'S MAJOR AND NONMAJOR FUNDS

As the City completed 2005/2006, its governmental funds reported *combined* fund balances of \$1,049,530. This is a net decrease of \$132,170. The net changes are summarized in the following chart:

	General Fund	Local Street	Capital Projects	Downtown Development Projects	Nonmajor Governmental Funds	Total Governmental Funds
Fund Balance 06/30/05	\$ 198,985	\$ 50,174	\$ 743,107	\$ -	\$ 189,434	\$ 1,181,700
Fund Balance 06/30/06	\$ 202,325	\$ 113,291	\$ 163,039	\$ 339,101	\$ 231,774	\$ 1,049,530
Net Change	\$ 3,340	\$ 63,117	\$ (580,068)	\$ 339,101	\$ 42,340	\$ (132,170)

General Fund:

The General Fund is the chief operating fund of the City. Unless otherwise required by statute, contractual agreement or Council policy, all City revenues and expenditures are recorded in the General Fund. As of June 30, 2006, the General Fund reported a fund balance of \$202,325. This amount is a decrease of \$3,340 from the fund balance of \$198,985 reported as of June 30, 2005. The 2005/2006 original budget had called for a \$2,878 decrease of fund balance.

City of Montrose

MANAGEMENT'S DISCUSSION AND ANALYSIS

June 30, 2006

The General Fund 2006/2007 revenues exceeded 2006/2007 expenditures by \$3,340 due in large part by disciplined fiscal management by all City officials over the course of the fiscal year.

General Fund Budgetary Highlights:

The City of Montrose's budget is a dynamic document. Although adopted in May (prior to the start of the year), the budget is routinely amended during the course of the year to reflect changing operational demands.

Actual General Fund revenue and other financing sources totaled \$834,928, \$414,627 below the final amended budget. There were some wide variations in individual revenue accounts reflecting the tightening national and local economy.

The City's expenditures and other financing uses budget was increased by \$383,151 (44% above the original budget) during 2005/2006.

Actual City expenditures and other financing uses for 2005/2006 were \$415,808 below the amended budget and \$32,624 below the original budget.

Local Street Fund

As of June 30, 2006, the Local Street Fund reported a fund balance \$113,291, which is an increase of \$63,117 from the prior year. The total fund balance is undesignated/unreserved. The reason for the significant increase in fund balance was monies are being accumulated to finance future years' street repairs.

Capital Projects Fund

As of June 30, 2006, the Capital Projects Fund reported a fund balance \$163,039. This fund was established with the purpose of making capital improvements to the City. The total fund balance is designated for capital expenditures.

Downtown Development Projects Fund

As of June 30, 2006, the Downtown Development Projects Fund reported a fund balance \$339,101. This fund was established in the current year with the purpose of making downtown development capital improvements to the City. The total fund balance is designated for capital expenditures.

Business-type Activities Funds

As the City completed 2005/2006, its business-type activities funds reported *combined* net assets of \$2,869,772. This is a net increase of \$23,821. The net changes are summarized in the following chart.

	Sewer System Fund	Water System Fund	Total
Net Assets 06/30/05	\$ 1,501,731	\$ 1,344,220	\$ 2,845,951
Net Assets 06/30/06	\$ 1,499,279	\$ 1,370,493	\$ 2,869,772
Net Change	\$ (2,452)	\$ 26,273	\$ 23,821

City of Montrose

MANAGEMENT'S DISCUSSION AND ANALYSIS

June 30, 2006

Sewer System Fund:

As of June 30, 2006, the Sewer Fund reported net assets of \$1,499,279, a decrease of \$2,452 from the prior year. The net assets balance is divided between \$720,864 invested in capital assets, net of related debt, and \$778,415 as unrestricted.

Water System Fund:

As of June 30, 2006, the Water System Fund reported a fund balance of \$1,370,493, an increase of \$26,273 from the prior year. The net assets balance is divided between \$770,038 invested in capital assets, net of related debt; \$70,392 is restricted for debt service or water assessment, and \$530,063 as unrestricted.

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets - At the end of Fiscal Year 2005/2006, the City had invested \$3,556,394, and \$116,679 for the component unit, net of accumulated depreciation, in a broad range of capital assets (see table below). Additional information related to capital assets is detailed in Note D of the Financial Statements. Net Book value of capital assets at June 30, 2006 was as follows:

	Governmental Activities	Business- type Activities	Component Unit DDA	Total
Land	\$ 99,000	\$ 50,620	\$ 38,000	\$ 187,620
Construction in progress	113,879	64,120	-	177,999
Vehicles and equipment, net	96,016	-	-	96,016
Sewer system, net	-	660,073	-	660,073
Water system, net	-	1,461,089	-	1,461,089
Infrastructure Streets & Bridges, net	1,011,597	-	78,579	1,090,176
Capital assets, net	\$ 1,320,492	\$ 2,235,902	\$ 116,579	\$ 3,672,973

Long-term Debt - As of June 30, 2006, the City had \$1,932,060 in loans outstanding for the primary government. This level of net obligation is \$315,213 more than the obligation recorded as of June 30, 2005, principally due to the 2006 General Obligation Bonds.

Outstanding Debt as of June 30, 2006:

Primary Government	<u>July 1, 2005</u>	<u>Additions</u>	<u>Reductions</u>	<u>June 30, 2006</u>
Governmental Activities				
General Obligation Bonds	\$ 750,000	\$ 405,000	\$ 35,000	\$ 1,120,000
Installment Loan	74,055	-	23,396	50,659
Compensated Absences	4,480	719	-	5,199
Business-type Activities				
Water Revenue Bonds	780,000	-	35,000	745,000
Compensated Absences	8,312	2,890	-	11,202
Total Reporting Entity	<u>\$ 1,616,847</u>	<u>\$ 408,609</u>	<u>\$ 93,396</u>	<u>\$ 1,932,060</u>

A more detailed discussion of the City's long-term debt obligations is presented in Note E to the financial statements.

City of Montrose

MANAGEMENT'S DISCUSSION AND ANALYSIS

June 30, 2006

ECONOMIC OUTLOOK:

- Property tax revenue has not kept pace with inflation.
- Health and dental insurance premiums are rising much faster than the rate of inflation.
- Retirement costs are increasing due to numerous financial market conditions coupled with demographic changes in the workforce.
- Utility costs are rising faster than the rate of inflation.
- There has been very little private investment construction of new buildings within the City over the past few years.
- Genesee County suffers from one of the highest unemployment rates in Michigan because of auto industry downsizing efforts of its labor force over the past few years that continues into the present.
- State revenue sharing has actually declined over the past few years as the Michigan economy continues to struggle without a recovery on the close horizon.

CONTACTING THE CITY

This financial report is designed to provide our citizens, taxpayers, customers, investors, and creditors with a general overview of the City's finances and to demonstrate the City's accountability for the money it receives. If there are questions about this report, or a need for additional information, contact the City of Montrose's Office at (810) 639-6168.

BASIC FINANCIAL STATEMENTS

City of Montrose

STATEMENT OF NET ASSETS

June 30, 2006

	Primary Government			
	Governmental Activities	Business-type Activities	Total	Component Unit
ASSETS				
Current assets				
Cash and cash equivalents	\$ 1,064,278	\$ 1,299,689	\$ 2,363,967	\$ 67,980
Receivables	148,242	95,329	243,571	-
Prepays	43,398	18,218	61,616	-
Due from other governmental units	24,032	-	24,032	-
Total current assets	1,279,950	1,413,236	2,693,186	67,980
Noncurrent assets				
Cash - restricted	-	77,328	77,328	-
Capital assets not being depreciated	212,879	114,740	327,619	38,000
Capital assets, net of accumulated depreciation	1,107,613	2,121,162	3,228,775	78,579
Total noncurrent assets	1,320,492	2,313,230	3,633,722	116,579
TOTAL ASSETS	2,600,442	3,726,466	6,326,908	184,559
LIABILITIES				
Current liabilities				
Accounts payable	96,219	88,100	184,319	11,219
Accrued liabilities	4,743	1,816	6,559	-
Accrued interest payable	5,317	9,063	14,380	-
Current portion of compensated absences	1,300	2,801	4,101	-
Current portion of long-term debt	64,749	35,000	99,749	-
Total current liabilities	172,328	136,780	309,108	11,219
Noncurrent liabilities				
Compensated absences	3,899	8,401	12,300	-
Customer deposits	-	1,513	1,513	-
Noncurrent portion of long-term debt	1,105,910	710,000	1,815,910	-
Total noncurrent liabilities	1,109,809	719,914	1,829,723	-0-
TOTAL LIABILITIES	1,282,137	856,694	2,138,831	11,219
NET ASSETS				
Invested in capital assets, net of related debt	149,833	1,490,902	1,640,735	78,579
Restricted for:				
Streets	327,901	-	327,901	-
Debt service	-	66,752	66,752	-
Water assessment	-	3,640	3,640	-
Capital projects	502,140	-	502,140	-
Unrestricted	338,431	1,308,478	1,646,909	94,761
TOTAL NET ASSETS	\$ 1,318,305	\$ 2,869,772	\$ 4,188,077	\$ 173,340

See accompanying notes to financial statements.

City of Montrose
STATEMENT OF ACTIVITIES
Year Ended June 30, 2006

Functions/Programs	Expenses	Program Revenues			Net (Expense) Revenue and Changes in Net Assets			
		Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	Primary Government			Component Unit
					Governmental Activities	Business-type Activities	Total	
Primary government:								
Governmental activities:								
General government	\$ 371,345	\$ 119,581	\$ 18,623	\$ -	\$ (233,141)	\$ -	\$ (233,141)	\$ -
Public safety	274,446	15,323	-	-	(259,123)	-	(259,123)	-
Public works	216,112	77,548	116,247	68,138	45,821	-	45,821	-
Community and economic development	13,640	-	-	-	(13,640)	-	(13,640)	-
Recreation and cultural	19,713	-	-	-	(19,713)	-	(19,713)	-
Interest on long-term debt	36,005	-	-	-	(36,005)	-	(36,005)	-
Total governmental activities	931,261	212,452	134,870	68,138	(515,801)	-0-	(515,801)	-0-
Business-type activities:								
Sewer system	305,591	282,475	610	-	-	(22,506)	(22,506)	-
Water system	367,909	294,354	77,474	-	-	3,919	3,919	-
Total business-type activities	673,500	576,829	78,084	-0-	-0-	(18,587)	(18,587)	-0-
Total primary government	<u>\$ 1,604,761</u>	<u>\$ 789,281</u>	<u>\$ 212,954</u>	<u>\$ 68,138</u>	(515,801)	(18,587)	(534,388)	-0-
Component unit:								
Downtown Development Authority	<u>\$ 81,202</u>	<u>\$ -0-</u>	<u>\$ -0-</u>	<u>\$ -0-</u>	-	-	-0-	(81,202)
General revenues:								
Property taxes					402,946	-	402,946	60,329
State shared revenues					191,875	-	191,875	-
Investment earnings					13,016	41,784	54,800	999
Miscellaneous					50,943	624	51,567	-
Total general revenues					658,780	42,408	701,188	61,328
Change in net assets					142,979	23,821	166,800	(19,874)
Net assets, beginning of the year					1,175,326	2,845,951	4,021,277	193,214
Net assets, end of the year					<u>\$ 1,318,305</u>	<u>\$ 2,869,772</u>	<u>\$ 4,188,077</u>	<u>\$ 173,340</u>

See accompanying notes to financial statements.

City of Montrose

GOVERNMENTAL FUNDS BALANCE SHEET

June 30, 2006

		Special Revenue
	General	Local Street
ASSETS		
Cash and cash equivalents	\$ 166,967	\$ 107,570
Receivables		
Accounts	420	5,529
Special assessments	-	114,923
Prepays	42,325	525
Due from other governmental units	24,032	-
TOTAL ASSETS	\$ 233,744	\$ 228,547
LIABILITIES AND FUND BALANCES		
LIABILITIES		
Accounts payable	\$ 29,301	\$ 60
Accrued liabilities	2,118	273
Deferred revenue	-	114,923
TOTAL LIABILITIES	31,419	115,256
FUND BALANCES		
Reserved for prepaids	42,325	525
Reserved for debt service	-	-
Reserved for rubbish levy	12,241	-
Unreserved		
Designated for capital expenditures	-	-
Undesignated, reported in:		
General Fund	147,759	-
Special Revenue Funds	-	112,766
TOTAL FUND BALANCES	202,325	113,291
TOTAL LIABILITIES AND FUND BALANCES	\$ 233,744	\$ 228,547

See accompanying notes to financial statements.

Capital Projects			
Capital Projects	Downtown Development Projects	Nonmajor Governmental Funds	Total Governmental Funds
\$ 166,509	\$ 400,086	\$ 223,146	\$ 1,064,278
-	-	12,835	18,784
-	-	14,535	129,458
-	-	548	43,398
-	-	-	24,032
<u>\$ 166,509</u>	<u>\$ 400,086</u>	<u>\$ 251,064</u>	<u>\$ 1,279,950</u>
\$ 3,470	\$ 60,985	\$ 2,403	\$ 96,219
-	-	2,352	4,743
-	-	14,535	129,458
<u>3,470</u>	<u>60,985</u>	<u>19,290</u>	<u>230,420</u>
-	-	548	43,398
-	-	2	2
-	-	-	12,241
163,039	339,101	-	502,140
-	-	-	147,759
-	-	231,224	343,990
<u>163,039</u>	<u>339,101</u>	<u>231,774</u>	<u>1,049,530</u>
<u>\$ 166,509</u>	<u>\$ 400,086</u>	<u>\$ 251,064</u>	<u>\$ 1,279,950</u>

City of Montrose

RECONCILIATION OF THE GOVERNMENTAL FUNDS BALANCE SHEET
TO THE STATEMENT OF NET ASSETS

June 30, 2006

Total fund balance - governmental funds **\$ 1,049,530**

Amounts reported for the governmental activities in the statement of net assets are different because:

Capital assets used in governmental activities are not financial resources
and therefore are not reported as assets in the governmental funds.

The cost of capital assets is	\$ 1,683,453	
Accumulated depreciation is	<u>(362,961)</u>	
Capital assets, net		1,320,492

Long-term receivables are not available to pay for current period expenditures
and are therefore deferred in the funds. These consist of:

Deferred revenue	129,458
------------------	---------

Long-term liabilities are not due and payable in the current period and
therefore are not reported in the Governmental Funds Balance Sheet.
Long-term liabilities at year-end consist of:

Direct City obligations	1,170,659	
Accrued interest payable	5,317	
Compensated absences	<u>5,199</u>	
		<u>(1,181,175)</u>

Net assets of governmental activities **\$ 1,318,305**

See accompanying notes to financial statements.

City of Montrose

Governmental Funds

STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES

Year Ended June 30, 2006

		Special Revenue
	General	Local Street
REVENUES		
Taxes	\$ 415,249	\$ -
Licenses and permits	20,401	-
Intergovernmental	191,875	29,173
Charges for services	147,089	-
Fines and forfeits	6,988	-
Interest and rents	35,649	699
Other	17,677	57,915
TOTAL REVENUES	834,928	87,787
EXPENDITURES		
Current		
General government	340,718	-
Public safety	274,446	-
Public works	101,106	44,103
Community and economic development	3,288	-
Recreation and cultural	19,713	-
Debt service		
Principal	23,396	-
Interest	3,277	-
Capital outlay	-	-
TOTAL EXPENDITURES	765,944	44,103
EXCESS OF REVENUES OVER (UNDER) EXPENDITURES	68,984	43,684
OTHER FINANCING SOURCES (USES)		
Bond proceeds	-	-
Transfers in	-	19,433
Transfers out	(65,644)	-
TOTAL OTHER FINANCING SOURCES (USES)	(65,644)	19,433
NET CHANGE IN FUND BALANCES	3,340	63,117
Fund balances, beginning of year	198,985	50,174
Fund balances, end of year	\$ 202,325	\$ 113,291

See accompanying notes to financial statements.

Capital Projects		Nonmajor Governmental Funds	Total Governmental Funds
Capital Projects	Downtown Development Projects		
\$ -	\$ -	\$ -	\$ 415,249
-	-	-	20,401
-	-	102,075	323,123
-	-	-	147,089
-	-	-	6,988
3,909	312	3,893	44,462
1,493	-	14,154	91,239
5,402	312	120,122	1,048,551
-	-	-	340,718
-	-	-	274,446
-	-	45,913	191,122
-	-	10,352	13,640
-	-	-	19,713
-	-	35,000	58,396
-	-	32,728	36,005
585,470	66,211	-	651,681
585,470	66,211	123,993	1,585,721
(580,068)	(65,899)	(3,871)	(537,170)
-	405,000	-	405,000
-	-	65,644	85,077
-	-	(19,433)	(85,077)
-0-	405,000	46,211	405,000
(580,068)	339,101	42,340	(132,170)
743,107	-	189,434	1,181,700
<u>\$ 163,039</u>	<u>\$ 339,101</u>	<u>\$ 231,774</u>	<u>\$ 1,049,530</u>

City of Montrose

RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES, AND
CHANGES IN FUND BALANCES OF GOVERNMENTAL FUNDS TO THE STATEMENT OF ACTIVITIES

Year Ended June 30, 2006

Net change in fund balances - total governmental funds \$ (132,170)

Amounts reported for governmental activities in the statement of activities are different because:

Capital outlays are reported as expenditures in governmental funds. However, in the statement of activities, the cost of capital assets is allocated over their estimated useful lives as depreciation expense. In the current period, these amounts are:

Capital outlay	\$ 628,704
Depreciation expense	<u>(32,544)</u>

Excess of capital outlay over depreciation expense	596,160
--	---------

Revenues in the statement of activities that do not provide current financial resources are not reported as revenues in the funds.	25,689
--	--------

Repayment of long-term debt and borrowing of long-term debt is reported as expenditures and other financing sources in governmental funds, but the repayment reduces long-term liabilities and the borrowings increases long-term liabilities in the statement of net assets. In the current year, these amounts consist of:

Bond and loan principal retirement	58,396
Bond proceeds	(405,000)

Some items reported in the statement of activities do not require the use of current financial resources and therefore are not reported as expenditures in governmental funds. These activities consist of:

Decrease in accrued interest payable	623	
(Increase) in accrued compensated absences	<u>(719)</u>	
		<u>(96)</u>

Change in net assets of governmental activities	<u><u>\$ 142,979</u></u>
--	--------------------------

See accompanying notes to financial statements.

City of Montrose

Proprietary Funds

STATEMENT OF NET ASSETS

June 30, 2006

	Sewer System	Water System	Total
ASSETS			
Current assets			
Cash and cash equivalents	\$ 759,382	\$ 540,307	\$ 1,299,689
Accounts receivable	42,174	53,155	95,329
Prepays	10,923	7,295	18,218
Total current assets	812,479	600,757	1,413,236
Noncurrent assets			
Cash - restricted	-	77,328	77,328
Capital assets not being depreciated	60,791	53,949	114,740
Capital assets, net of accumulated depreciation	660,073	1,461,089	2,121,162
Total noncurrent assets	720,864	1,592,366	2,313,230
TOTAL ASSETS	1,533,343	2,193,123	3,726,466
LIABILITIES			
Current liabilities			
Accounts payable	27,867	60,233	88,100
Wages payable	750	1,066	1,816
Accrued liabilities	-	9,063	9,063
Current portion of compensated absences	1,362	1,439	2,801
Current portion of long-term debt	-	35,000	35,000
Total current liabilities	29,979	106,801	136,780
Noncurrent liabilities			
Payable from restricted cash -			
Customer deposits payable	-	1,513	1,513
Compensated absences	4,085	4,316	8,401
Bonds payable	-	710,000	710,000
Total noncurrent liabilities	4,085	715,829	719,914
TOTAL LIABILITIES	34,064	822,630	856,694
NET ASSETS			
Invested in capital assets, net of related debt	720,864	770,038	1,490,902
Restricted for debt service	-	66,752	66,752
Restricted for water assessment	-	3,640	3,640
Unrestricted	778,415	530,063	1,308,478
TOTAL NET ASSETS	\$ 1,499,279	\$ 1,370,493	\$ 2,869,772

See accompanying notes to financial statements.

City of Montrose

Proprietary Funds

STATEMENT OF REVENUE, EXPENSES, AND CHANGES IN FUND NET ASSETS

Year Ended June 30, 2006

	Sewer System	Water System	Total
OPERATING REVENUES			
Charges for services			
User charges	\$ 282,475	\$ 279,014	\$ 561,489
Tap in fees	-	2,800	2,800
Other	-	624	624
TOTAL OPERATING REVENUES	282,475	282,438	564,913
OPERATING EXPENSES			
Salaries and wages	20,349	31,466	51,815
Fringe benefits	17,668	17,683	35,351
Contractual service	135,456	168,707	304,163
Administration fee	45,156	45,000	90,156
Supplies	2,447	3,747	6,194
Utilities	3,153	5,988	9,141
Insurance	10,075	-	10,075
Repairs and maintenance	11,281	8,725	20,006
Other	2,167	2,376	4,543
Depreciation	57,839	45,654	103,493
TOTAL OPERATING EXPENSES	305,591	329,346	634,937
OPERATING LOSS	(23,116)	(46,908)	(70,024)
NONOPERATING REVENUES (EXPENSES)			
Hydrant assessments	-	12,540	12,540
Special assessments	610	77,474	78,084
Interest revenue	20,054	21,730	41,784
Interest expense	-	(38,563)	(38,563)
TOTAL NONOPERATING REVENUES (EXPENSES)	20,664	73,181	93,845
CHANGE IN NET ASSETS	(2,452)	26,273	23,821
Net assets, beginning of year	1,501,731	1,344,220	2,845,951
Net assets, end of year	\$ 1,499,279	\$ 1,370,493	\$ 2,869,772

See accompanying notes to financial statements.

City of Montrose

Proprietary Funds

STATEMENT OF CASH FLOWS

Year Ended June 30, 2006

	Sewer System	Water System	Total
CASH FLOWS FROM OPERATING ACTIVITIES			
Cash receipts from customers	\$ 283,959	\$ 283,755	\$ 567,714
Cash paid to suppliers	(220,984)	(202,631)	(423,615)
Cash paid for employee benefits	(16,377)	(16,521)	(32,898)
Cash paid to employees	(19,958)	(30,970)	(50,928)
NET CASH PROVIDED BY OPERATING ACTIVITIES	26,640	33,633	60,273
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES			
Hydrant assessments	-	12,540	12,540
Special assessments	610	77,474	78,084
Interest expense	-	(38,563)	(38,563)
Capital purchases	(15,171)	(414,930)	(430,101)
Payments on borrowings	-	(35,000)	(35,000)
NET CASH (USED) BY CAPITAL AND RELATED FINANCING ACTIVITIES	(14,561)	(398,479)	(413,040)
CASH FLOWS FROM INVESTING ACTIVITIES			
Interest revenue	20,054	21,730	41,784
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	32,133	(343,116)	(310,983)
Cash and cash equivalents, beginning of year	727,249	960,751	1,688,000
Cash and cash equivalents, end of year	<u>\$ 759,382</u>	<u>\$ 617,635</u>	<u>\$ 1,377,017</u>
Reconciliation of operating loss to net cash provided by operating activities			
Operating loss	\$ (23,116)	\$ (46,908)	\$ (70,024)
Adjustments to reconcile operating loss to net cash provided by operating activities			
Depreciation	57,839	45,654	103,493
Decrease in accounts receivable	1,484	1,488	2,972
(Increase) in prepaids	(10,923)	(7,295)	(18,218)
Increase (decrease) in accounts payable	(326)	39,207	38,881
Increase in wages payable	391	496	887
(Decrease) in other accrued liabilities	-	(437)	(437)
Increase in compensated absences	1,291	1,599	2,890
(Decrease) in customer deposits	-	(171)	(171)
NET CASH PROVIDED BY OPERATING ACTIVITIES	\$ 26,640	\$ 33,633	\$ 60,273

See accompanying notes to financial statements.

City of Montrose

Fiduciary Funds

STATEMENT OF FIDUCIARY NET ASSETS

June 30, 2006

	Current Tax Collection	Delinquent Tax Collection	Total
ASSETS			
Cash	<u>\$ 22,463</u>	<u>\$ 3,971</u>	<u>\$ 26,434</u>
LIABILITIES			
Due to other governmental units	<u>\$ 22,463</u>	<u>\$ 3,971</u>	<u>\$ 26,434</u>

See accompanying notes to financial statements.

NOTES TO FINANCIAL STATEMENTS

June 30, 2006

NOTE A: DESCRIPTION OF CITY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The City of Montrose is located in Genesee County, Michigan and has a population of approximately 1,811. The City of Montrose operates with a Council form of government and provides services to its residents in many areas including general government, highways and streets, human services, and utilities services.

The City has six (6) City Council members who are elected at large for overlapping four (4) year terms and a Mayor elected at large for a two (2) year term. The Council appoints the City Manager, Treasurer, Clerk, and Assessor.

The financial statements of the City have been prepared in accordance with generally accepted accounting principles (GAAP) as applied to City governments. The Governmental Accounting Standards Board is the accepted standard-setting body for establishing governmental accounting and financial reporting principles. The City's more significant accounting policies are described below.

1. Reporting Entity

As required by accounting principles generally accepted in the United States of America; GASB Statement No. 14, *The Financial Reporting Entity* (as amended by GASB Statement No. 39); and *Statement on Michigan Governmental Accounting and Auditing No. 5*, these financial statements present the financial activities of the City of Montrose (primary government) and its component unit, an entity for which the government is considered to be financially accountable. The discretely presented component unit is reported in a separate column in the government-wide financial statements to emphasize that it is legally separate from the City.

2. Discretely Presented Component Unit

The component unit columns in the financial statements include the financial data of the City's component unit (Downtown Development Authority). The governing body of the Downtown Development Authority is appointed by the City Council, the Authority's budget is subject to the approval of the City Council and the City temporarily relinquishes part of its tax base to the Authority (tax increment revenues).

3. Basis of Presentation

GOVERNMENT-WIDE FINANCIAL STATEMENTS

The statement of net assets and the statement of activities (the government-wide statements) present information for the primary government and its component unit as a whole. All non-fiduciary activities of the primary government are included (i.e., fiduciary fund activities are not included in the government-wide statements). For the most part, interfund activity has been eliminated in the preparation of these statements. Governmental activities, which normally are supported by taxes and intergovernmental revenues, are reported separately from business-type activities, which rely to a significant extent on fees and charges for support.

The statement of activities presents the direct functional expenses of the primary government and its component unit and the program revenues that support them. Direct expenses are specifically associated with a service, program, or department and are therefore clearly identifiable to a particular function. Program revenues are associated with specific functions and include charges to recipients of goods or services and grants and contributions that are restricted to meeting the operational or capital requirements of that function. Revenues that are not required to be presented as program revenues are general revenues. This includes all taxes, interest, and unrestricted State revenue sharing payments and other general revenues and shows how governmental functions are either self-financing or supported by general revenues.

NOTES TO FINANCIAL STATEMENTS

June 30, 2006

NOTE A: DESCRIPTION OF CITY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

3. Basis of Presentation - continued

FUND FINANCIAL STATEMENTS

The fund financial statements present the City's individual major funds and aggregated nonmajor funds. Separate financial statements are provided for governmental funds, proprietary funds, and fiduciary funds, even though the latter are excluded from the government-wide financial statements. Major individual governmental funds and major individual enterprise funds are reported as separate columns in the fund financial statements.

The major funds of the City are:

- a. The General Fund is the City's primary operating fund. It accounts for all financial resources of the general government except for those that are required to be accounted for in another fund.
- b. The Local Street Fund is used to account for the financial resources that are used for repairs and maintenance of the City's local streets.
- c. The Capital Projects Fund accounts for resources, which have the purpose of making capital improvements to the City.
- d. The Downtown Development Capital Projects Fund accounts for resources, which have the purpose of making capital improvements to the City's downtown area.
- e. The Sewer System Fund accounts for resources generated by providing sewer services to residents of the City; the costs (expenses, including depreciation) are financed or recovered primarily through user charges.
- f. The Water System Fund accounts for resources generated by providing water services to residents of the City; the costs (expenses, including depreciation) are financed or recovered primarily through user charges.

4. Measurement Focus

The government-wide and proprietary fund financial statements are presented using the economic resources measurement focus, similar to that used by business enterprises or not-for-profit organizations. Because another measurement focus is used in the governmental fund financial statements, reconciliations to the government-wide statements are provided that explain the differences in detail.

All governmental funds are presented using the current financial resources measurement focus. With this measurement focus, only current assets and current liabilities generally are included on the balance sheet. Operating statements of these funds present increases (i.e., revenues and other financing sources) and decreases (i.e., expenditures and other financing uses) in net current assets.

There is no measurement focus for the fiduciary agency fund since assets equal liabilities.

5. Basis of Accounting

Basis of accounting refers to when revenues and expenditures are recognized in the accounts and reported in the financial statements. Basis of accounting relates to the timing of the measurement made, regardless of the measurement focus applied.

All governmental funds are accounted for using the modified accrual basis of accounting. Under this method, revenues are recognized when they become susceptible to accrual (when they become both "measurable" and "available to finance expenditures of the current period"). The length of time used for "available" for purposes of revenue recognition in the governmental fund financial statements is 60 days.

NOTES TO FINANCIAL STATEMENTS

June 30, 2006

NOTE A: DESCRIPTION OF CITY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

5. Basis of Accounting - continued

Revenues that are considered measurable but not available are recorded as a receivable and deferred revenue. Significant revenues susceptible to accrual are special assessments and certain intergovernmental revenues. Expenditures are generally recognized under the modified accrual basis of accounting when the related fund liability is incurred, except for interest on long-term debt which is recorded when due.

All proprietary funds are accounted for using the accrual basis of accounting. Their revenues are recognized when they are earned, and their expenses are recognized when they are incurred.

Proprietary funds distinguish operating revenues and expenses from non-operating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. The principal operating revenues of the Enterprise Funds are charges to customers for sales and services. Operating expenses for enterprise funds include the costs of sales and services, administrative expenses, and other costs of running the activity. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses. If/when both restricted and unrestricted resources are available for use, it is the City's policy to use restricted resources first, then unrestricted resources as they are needed.

6. Budgets and Budgetary Accounting

The General and Special Revenue Funds' budgets are prepared on a basis consistent with the modified accrual basis used to reflect actual results. The City employs the following procedures in establishing its budgetary data.

- a. Prior to April 15, the City Manager submits to the City Council a proposed operating budget for the fiscal year beginning the following July 1. The operating budget includes proposed expenditures and the means of financing them.
- b. A Public Hearing is conducted to obtain taxpayers' comments.
- c. Prior to the second week of May, the budget is legally adopted by appropriating the funds necessary to operate.
- d. The budget is legally adopted at the functional level for the General Fund and Special Revenue Funds; however they are maintained at the account level for control purposes.
- e. The City does not employ encumbrance accounting as an extension of formal budgetary integration in the governmental funds. Appropriations unused at June 30 are not carried forward to the following fiscal year.
- f. Any revisions to the budget must be approved by the City Council.

7. Cash and Cash Equivalents

Cash and cash equivalents consist of various savings and money market checking accounts and pooled investment accounts. The cash and cash equivalents are recorded at cost, which approximates market value.

8. Restricted Cash

A portion of the cash and cash equivalents of the Water System Fund is classified as restricted cash because its use is limited. The Water System Fund's restrictions are due to bond resolution requirements to maintain certain balances in separate accounts for debt service and general purpose reserves, and also for the amount of customer deposits held at June 30, 2006.

NOTES TO FINANCIAL STATEMENTS

June 30, 2006

NOTE A: DESCRIPTION OF CITY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

9. Property Tax

The City of Montrose bills and collects its own property taxes and also taxes for other governmental units. The City's property tax revenue recognition policy and related tax calendar disclosures are highlighted in the following paragraph.

Property taxes are levied by the City of Montrose on July 1 and December 1 and are payable without penalty through September 30 and February 28, respectively. The July 1 levy is composed of the City's millage, 2/3 of the County's millage, special assessments, and the school taxes. The December 1 levy is composed of 1/3 of the County's millage, school taxes, and special assessments. All real property taxes not paid to the City by March 1 are turned over to the Genesee County Treasurer for collection. The Genesee County Treasurer purchases the receivables of all taxing districts on any delinquent real property taxes. Delinquent personal property taxes are retained by the City for subsequent collection. Collections and remittances of all taxes are accounted for in the Current Tax Collections Agency Fund. City property tax revenues are recognized as revenues in the fiscal year levied.

The City is permitted to levy taxes up to 20 mills (\$20 per \$1,000 of taxable valuation) for general governmental services. For the year ended June 30, 2006, the City levied 17.4004 mills per \$1,000 of assessed valuation for general governmental services. The total Taxable Value for the 2005 levy for property within the City was \$24,421,681.

10. Interfund Transactions

During the course of normal operations, the City has numerous transactions between funds, including expenditures and transfers of resources to provide services, construct assets, and service debt. The accompanying financial statements generally reflect such transactions as transfers. Transfers between individual governmental and individual proprietary funds are netted as part of the reconciliation to the government-wide financial statements.

11. Compensated Absences

City employees are granted sick and vacation leave in varying amounts. In the event of termination, an employee is paid for accumulated sick and vacation time. All employees with accumulated unused sick and vacation time pay at June 30, 2006 were vested and the total due to them, along with the related payroll taxes, is recorded in the governmental-wide financial statements. For proprietary funds, the cost is recorded as a fund liability when earned.

12. Capital Assets

Capital assets include land, buildings, equipment, and vehicles and are recorded (net of accumulated depreciation, if applicable) in the government-wide financial statements under the governmental activities and component unit columns. Capital assets are those with an initial individual cost of \$5,000 or more and an estimated useful life of more than three (3) years. Capital assets are not recorded in the governmental funds. Instead, capital acquisition and construction are reflected as expenditures in governmental funds, and the related assets are reported in the government-wide financial statements. All purchased capital assets are valued at cost where historical records are available and at an estimated historical cost where no historical records exist. Donated capital assets are valued at their estimated fair market value on the date received.

NOTES TO FINANCIAL STATEMENTS

June 30, 2006

NOTE A: DESCRIPTION OF CITY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED**12. Capital Assets - continued**

GASB Statement No. 34 requires major networks and major subsystems of infrastructure assets acquired, donated, constructed, or substantially rehabilitated since fiscal years ending after June 30, 1980, be inventoried and capitalized by the fourth anniversary of the mandated date of adoption of the other provisions of GASB Statement No. 34. The City of Montrose has capitalized infrastructure as required since implementing GASB Statement No. 34, and has reported the infrastructure in the Statement of Net Assets. The City of Montrose will retroactively capitalize the major infrastructure assets on or before June 30, 2008, as permitted by GASB Statement No. 34.

The cost of normal maintenance and repairs that do not add to the value of the asset or materially extend asset lives are not capitalized. Depreciation is computed using the straight-line method over the following useful lives:

Sewer and Water systems and improvements	10 - 50 years
Equipment and machinery	3 - 12 years
Buildings	25 years
Vehicles	10 years
Infrastructure	20 - 50 years

13. Long-term Liabilities

Long-term debt and other long-term obligations are recognized as a liability in the government-wide financial statements and proprietary fund types when incurred. The portion of those liabilities expected to be paid within the next year is a current liability with the remaining amounts shown as long-term.

Long-term debt is recognized as a liability of a governmental fund when due. For other long-term obligations, only that portion expected to be financed from expendable available financial resources is reported as a fund liability of a governmental fund.

14. Comparative Data

Comparative data for the prior year has not been presented in all funds in the accompanying financial statements since their inclusion would make the financial statements unduly complex and difficult to read.

NOTE B: CASH AND CASH EQUIVALENTS

In accordance with Michigan Compiled Laws, the City is authorized to invest in the following investment vehicles:

1. Bonds, securities, and other obligations of the United States or an agency or instrumentality of the United States.
2. Certificates of deposit, savings accounts, deposit accounts, or depository receipts of a State or nationally chartered bank or a State or Federally chartered savings and loan association, savings bank, or credit union whose deposits are insured by an agency of the United States government and which maintains a principal office or branch office located in this State under the laws of the State or the United States, but only if the bank, savings and loan association, savings bank, or credit union is eligible to be a depository of surplus funds belong to the State under Section 5 or 6 of Act No. 105 of the Public Acts of 1855, as amended, being Section 21.145 and 21.146 of Michigan Compiled Laws.

NOTES TO FINANCIAL STATEMENTS

June 30, 2006

NOTE B: CASH AND CASH EQUIVALENTS - CONTINUED

3. Commercial paper rated at the time of purchase within the three (3) highest classifications established by not less than two (2) standard rating services and which matures not more than 270 days after the date of purchase.
4. The United States government or federal agency obligations repurchase agreements.
5. Bankers acceptances of United States banks.
6. Mutual funds composed of investment vehicles, which are legal for direct investment by local units of government in Michigan.

Federal Deposit Insurance Corporation (FDIC) regulations provide that deposits of governmental units are to be separately insured for the amount of \$100,000 for deposits in an insured bank for savings deposits and \$100,000 for demand deposits. Furthermore, if specific deposits are regulated by statute or bond indenture, these specific deposits are to be separately insured for the amount of \$100,000. Michigan Compiled Laws allow for collateralization of government deposits, if the assets for pledging are acceptable to the State Treasurer under Section 3 of 1855 PA 105, MCL 21.143, to secure deposits of State surplus funds, securities issued by the Federal Loan Mortgage Corporation, Federal National Mortgage Association, or Government National Mortgage Association.

Deposits

As of June 30, 2006, the carrying amounts and bank balances for each type of bank account are as follows:

<u>Account Type</u>	<u>Carrying Amount</u>	<u>Bank Balance</u>
PRIMARY GOVERNMENT		
Checking and savings	\$ 1,516,287	\$ 1,561,426
COMPONENT UNIT		
Savings	67,980	67,980
FIDUCIARY FUNDS		
Checking and savings	<u>26,434</u>	<u>89,107</u>
TOTAL REPORTING UNIT	<u>\$ 1,610,701</u>	<u>\$ 1,718,513</u>

Deposits of the City are at federally insured banks located in the State of Michigan with all accounts maintained in the name of the City. As of June 30, 2006, the City accounts were insured by the FDIC for \$122,971, and the amount of \$1,595,542 was uninsured and uncollateralized.

Due to significantly higher cash flow at certain periods during the year, the amount the City held as cash and cash equivalents increased significantly. As a result, the amount of uninsured and uncollateralized cash and cash equivalents were substantially higher at these peak periods than at year-end.

NOTES TO FINANCIAL STATEMENTS

June 30, 2006

NOTE B: CASH AND CASH EQUIVALENTS - CONTINUEDInvestments

As of June 30, 2006, the carrying amounts and market values for each type of investment as reported in the cash and cash equivalents captions on the basic financial statements are as follows:

<u>INVESTMENT TYPE</u>	<u>Carrying Amount</u>	<u>Bank Balance</u>	<u>Weighted Average Maturity (years)</u>
PRIMARY GOVERNMENT			
Uncategorized pooled investment funds			
MBIA	\$ 282,391	\$ 282,391	38 days
Bank One	87,655	87,655	5 days
Public Funds Investment Trust	<u>554,962</u>	<u>554,962</u>	< 60 days
	<u>\$ 925,008</u>	<u>\$ 925,008</u>	

Credit risk

State law limits investments in certain types of investments to a prime or better rating issued by nationally recognized statistical rating organizations (NRSRO's). As of June 30, 2006, the Public Funds Investment Trust was rated AAA by Standard and Poor's. The Bank One investment was rated AAA by Moody's. The MBIA - Michigan Class investment is not rated.

Interest rate risk

The City will minimize interest rate risk, which is the risk that the market value of securities in the portfolio will fall due to changes in market interest rates, by structuring the investment portfolio so that securities mature to meet cash requirements for ongoing operations, thereby avoiding the need to sell securities in the open market and investing operating funds primarily in shorter-term securities, liquid asset funds, money market mutual funds, or similar investment pools and limiting the average maturity in accordance with the City's cash requirements.

Concentration of credit risk

The City will minimize concentration of credit risk, which is the risk of loss attributed to the magnitude of the City's investment in a single issuer, by diversifying the investment portfolio so that the impact of potential losses from any one type of security or issuer will be minimized.

The cash and cash equivalents and investments referred to above have been reported in the cash and cash equivalents caption on the basic financial statements, based upon criteria disclosed in Note A. The following summarizes the categorization of these amounts as of June 30, 2006:

	<u>Primary Government</u>	<u>Component Unit</u>	<u>Fiduciary Funds</u>	<u>Reporting Entity</u>
Cash and cash equivalents	\$ 2,363,967	\$ 67,980	\$ 26,434	\$ 2,458,381
Cash - restricted	<u>77,328</u>	<u>-</u>	<u>-</u>	<u>77,328</u>
	<u>\$ 2,441,295</u>	<u>\$ 67,980</u>	<u>\$ 26,434</u>	<u>\$ 2,535,709</u>

City of Montrose

NOTES TO FINANCIAL STATEMENTS

June 30, 2006

NOTE C: INTERFUND TRANSFERS

Permanent reallocation of resources between funds of the reporting entity is classified as interfund transfers. For the purpose of the statement of activities, all interfund transfers between individual governmental funds have been eliminated.

Transfers to nonmajor governmental funds from:	
General Fund	<u>\$ 65,644</u>
Transfer to Local Street Fund from:	
Nonmajor governmental funds	<u>\$ 19,433</u>

NOTE D: CAPITAL ASSETS

Capital asset activity for the year ended June 30, 2006 was as follows:

PRIMARY GOVERNMENT

	<u>Balance July 1, 2005</u>	<u>Additions/ Reclassifications</u>	<u>Deletions/ Reclassifications</u>	<u>Balance June 30, 2006</u>
Governmental activities				
Capital assets not being depreciated				
Construction in progress	\$ 88,994	\$ 56,243	\$(31,358)	\$ 113,879
Land	<u>99,000</u>	<u>-</u>	<u>-</u>	<u>99,000</u>
Total capital assets, not being depreciated	187,994	56,243	(31,358)	212,879
Capital assets being depreciated				
Buildings	68,800	-	-	68,800
Furniture and equipment	112,055	-	-	112,055
Vehicles	256,500	-	(8,000)	248,500
Infrastructure	<u>437,400</u>	<u>603,819</u>	<u>-</u>	<u>1,041,219</u>
Total capital assets, being depreciated	874,755	603,819	(8,000)	1,470,574
Less accumulated depreciation for:				
Buildings	(68,800)	-	-	(68,800)
Furniture and equipment	(32,056)	(7,554)	-	(39,610)
Vehicles	(224,286)	(8,643)	8,000	(224,929)
Infrastructure	<u>(13,275)</u>	<u>(16,347)</u>	<u>-</u>	<u>(29,622)</u>
Total accumulated depreciation	<u>(338,417)</u>	<u>(32,544)</u>	<u>8,000</u>	<u>(362,961)</u>
Net capital assets being depreciated	<u>536,338</u>	<u>571,275</u>	<u>-0-</u>	<u>1,107,613</u>
Capital assets, net	<u>\$ 724,332</u>	<u>\$ 627,518</u>	<u>\$(31,358)</u>	<u>\$ 1,320,492</u>

Depreciation expense was charged to activities of the following governmental activities:

General government	\$ 7,554
Public works	<u>24,990</u>
Total depreciation expense	<u>\$ 32,544</u>

City of Montrose

NOTES TO FINANCIAL STATEMENTS

June 30, 2006

NOTE D: CAPITAL ASSETS - CONTINUED

PRIMARY GOVERNMENT - CONTINUED

	Balance <u>July 1, 2005</u>	Additions/ <u>Reclassifications</u>	Deletions/ <u>Reclassifications</u>	Balance <u>June 30, 2006</u>
Business-type activities				
(Sewer system)				
Capital assets not being depreciated				
Land	\$ 50,620	\$ -	\$ -	\$ 50,620
Construction in progress	<u>5,468</u>	<u>10,171</u>	<u>(5,468)</u>	<u>10,171</u>
Total capital assets, not being depreciated	56,088	10,171	(5,468)	60,791
Capital assets being depreciated				
Sewer system	2,320,124	10,468	-	2,330,592
Equipment	<u>6,921</u>	<u>-</u>	<u>-</u>	<u>6,921</u>
Total capital assets, being depreciated	2,327,045	10,468	-0-	2,337,513
Less accumulated depreciation for:				
Sewer system	(1,612,680)	(57,839)	-	(1,670,519)
Equipment	<u>(6,921)</u>	<u>-</u>	<u>-</u>	<u>(6,921)</u>
Total accumulated depreciation	<u>(1,619,601)</u>	<u>(57,839)</u>	<u>-0-</u>	<u>(1,677,440)</u>
Net capital assets being depreciated	<u>707,444</u>	<u>(47,371)</u>	<u>-0-</u>	<u>660,073</u>
Capital assets, net	<u>\$ 763,532</u>	<u>\$(37,200)</u>	<u>\$(5,468)</u>	<u>\$ 720,864</u>
Business-type activities				
(Water system)				
Capital assets not being depreciated				
Construction in progress	\$ 6,296	\$ 53,949	\$(6,296)	\$ 53,949
Capital assets being depreciated				
Water system	1,924,281	367,277	-	2,291,558
Equipment	<u>6,922</u>	<u>-</u>	<u>-</u>	<u>6,922</u>
Total capital assets, being depreciated	1,931,203	367,277	-0-	2,298,480
Less accumulated depreciation for:				
Water system	(784,815)	(45,654)	-	(830,469)
Equipment	<u>(6,922)</u>	<u>-</u>	<u>-</u>	<u>(6,922)</u>
Total accumulated depreciation	<u>(791,737)</u>	<u>(45,654)</u>	<u>-0-</u>	<u>(837,391)</u>
Net capital assets being depreciated	<u>1,139,466</u>	<u>321,623</u>	<u>-0-</u>	<u>1,461,089</u>
Capital assets, net	<u>\$ 1,145,762</u>	<u>\$ 375,572</u>	<u>\$(6,296)</u>	<u>\$ 1,515,038</u>

City of Montrose

NOTES TO FINANCIAL STATEMENTS

June 30, 2006

NOTE D: CAPITAL ASSETS - CONTINUED

COMPONENT UNIT

	Balance July 1, 2005	Additions	Deletions	Balance June 30, 2006
Downtown Development Authority				
Capital assets not being depreciated				
Land	\$ 38,000	\$ -	\$ -	\$ 38,000
Capital assets being depreciated				
Infrastructure	98,223	-	-	98,223
Less accumulated depreciation for:				
Infrastructure	(9,822)	(9,822)	-	(19,644)
Net capital assets being depreciated	88,401	(9,822)	-0-	78,579
Capital assets, net	\$ 126,401	\$ (9,822)	\$ -0-	\$ 116,579

NOTE E: LONG-TERM DEBT

The following is a summary of changes in long-term debt (including current portion) of the City for the year ended June 30, 2006:

	Balance July 1, 2005	Additions	Deletions	Balance June 30, 2006	Amounts Due Within One Year
PRIMARY GOVERNMENT					
Governmental activities					
2006 General Obligation Bonds	\$ -	\$ 405,000	\$ -	\$ 405,000	\$ -
2005 General Obligation Bonds	750,000	-	35,000	715,000	40,000
Installment loan	74,055	-	23,396	50,659	24,749
Accumulated sick/vacation	4,480	719	-	5,199	1,300
	828,535	405,719	58,396	1,175,858	66,049
Business-type activities					
Enterprise Funds					
Water System Fund					
1981 Water Revenue Bonds	780,000	-	35,000	745,000	35,000
Accumulated sick/vacation	4,156	1,599	-	5,755	1,439
	784,156	1,599	35,000	750,755	36,439
Sewer System Fund					
Accumulated sick/vacation	4,156	1,291	-	5,447	1,362
	788,312	2,890	35,000	756,202	37,801
TOTAL PRIMARY GOVERNMENT	\$ 1,616,847	\$ 408,609	\$ 93,396	\$ 1,932,060	\$ 103,850

City of Montrose

NOTES TO FINANCIAL STATEMENTS

June 30, 2006

NOTE E: LONG-TERM DEBT - CONTINUED

Significant details regarding outstanding long-term debt (including current portion) are presented below:

PRIMARY GOVERNMENT

Accrued Sick/Vacation

Individual employees have vested rights upon termination of employment to receive payments for unused vacation and sick leave. The dollar amounts of these vested rights including related payroll taxes, which have been accrued in the financial statements either on the respective fund Balance Sheet or the governmental-wide financial statements, amounted to approximately \$16,401 at June 30, 2006. Of this amount, \$11,202 is recorded as a liability within the Enterprise funds, in accordance with criteria disclosed in Note A.

General Obligation Bonds

\$405,000 Downtown Development Authority Bonds, dated May 1, 2006, due in annual installments ranging from \$15,000 to \$50,000 through September 1, 2020, with interest ranging from 4.50 to 4.60 percent, payable semi-annually. \$ 405,000

\$750,000 Limited Tax General Obligation Bonds, dated May 1, 2005, due in annual installments ranging from \$40,000 to \$65,000 through May 1, 2020, with interest ranging from 4.00 to 5.00 percent, payable semi-annually. 715,000

\$ 1,120,000

Revenue Bonds

\$940,000 1981 Water Revenue Bonds, due in annual installments ranging from \$25,000 to \$70,000 through April 1, 2021 with interest at 5.00 percent, payable semi-annually. \$ 745,000

Installment Loan Payable

\$74,055 Installment Loan Payable for a backhoe, dated May 6, 2005, due in monthly payments ranging from \$2,022 to \$2,205, with interest of 4.60 percent. \$ 50,659

The annual requirements to pay the debt principal and interest outstanding for the bonds are as follows:

Year Ending June 30,	<u>General Obligation</u>		<u>Revenue Bonds</u>		<u>Installment Loans</u>	
	<u>Principal</u>	<u>Interest</u>	<u>Principal</u>	<u>Interest</u>	<u>Principal</u>	<u>Interest</u>
2007	\$ 40,000	\$ 30,753	\$ 35,000	\$ 36,250	\$ 24,749	\$ 1,820
2008	55,000	46,690	40,000	34,500	25,910	640
2009	55,000	44,015	40,000	32,500	-	-
2010	60,000	41,340	40,000	30,500	-	-
2011	65,000	38,753	45,000	28,500	-	-
2012-2016	385,000	149,558	260,000	107,000	-	-
2017-2021	<u>460,000</u>	<u>53,028</u>	<u>285,000</u>	<u>35,500</u>	<u>-</u>	<u>-</u>
	<u>\$ 1,120,000</u>	<u>\$ 404,137</u>	<u>\$ 745,000</u>	<u>\$ 304,750</u>	<u>\$ 50,659</u>	<u>\$ 2,460</u>

NOTES TO FINANCIAL STATEMENTS

June 30, 2006

NOTE F: RISK MANAGEMENT

The City participates in a pool, the Michigan Township Participating Plan with other municipalities for various risks of loss including employer's liability, errors and omissions, and property and casualty losses. The pool is organized under Public Act 138 of 1982, as amended. The City has no liability for additional assessments based on the claims filed against the pool nor do they have any right to dividends.

The City also participates in a pool, the Michigan Municipal Workers' Compensation Fund, with other municipalities for workers' compensation losses. The pool is organized under Public Act 317 of 1969, as amended. The City has no liability for additional assessments based on the claims filed against the pool nor do they have any right to dividends.

NOTE G: RETIREMENT PLANPlan Description

The City participates in the Michigan Municipal Employees Retirement System, an agent multiple-employer defined benefit pension plan that covers all eligible full-time employees of the City. The system provides retirement, disability, and death benefits to plan members and their beneficiaries.

Funding Policy

The Michigan Municipal Employees Retirement System issues a publicly available financial report that includes financial statements and required supplementary information for the system. That report may be obtained by writing to the System at 1134 Municipal Way, Lansing, Michigan 48917.

The obligation to contribute to and maintain the system for these employees was established by the City Council and by negotiation with the City's collective bargaining units. The plan requires no contribution from the employees.

Annual Pension Cost

For year ended June 30, 2006, the City's annual pension cost of \$45,984 for the plan was equal to the City's required and actual contribution. The estimated annual required contribution was determined as part of an actuarial valuation at December 31, 2003, using the entry actual age cost method. Actual required contributions are based on actual reported monthly payroll. Significant actuarial assumptions used include a (a) 8.00 percent investment rate of return (b) projected salary increases of 4.5 percent per year compounded annually, attributable to inflation (c) additional salary increases ranging from 0% to 8.4% per year depending on age, seniority and merit, and (d) assumption benefits will not increase after retirement.

The actuarial value of assets was determined using techniques that smooth the effects of short term volatility over a four (4) year period. The unfunded actuarial liability is being amortized as a level percentage of payroll over a period of thirty years.

Three (3) year trend information

	Year Ended December 31,		
	<u>2003</u>	<u>2004</u>	<u>2005</u>
Actuarial value of assets	\$ 282,739	\$ 334,075	\$ 367,435
Actuarial accrued liability (AAL) (entry age)	624,005	744,335	803,162
Unfunded AAL	341,266	410,260	435,727
Funded ratio	45 %	45 %	46 %
Covered payroll	153,392	125,454	197,533
UAAL as a percentage of covered payroll	222 %	327 %	221 %

City of Montrose

NOTES TO FINANCIAL STATEMENTS

June 30, 2006

NOTE G: RETIREMENT PLAN - CONTINUED

Three (3) year trend information - continued

	Year Ended June 30,		
	<u>2004</u>	<u>2005</u>	<u>2006</u>
Annual pension cost	\$ 42,393	\$ 34,587	\$ 45,984
Percentage of APC contributed	100 %	100 %	100 %
Net pension obligation	-	-	-

This trend information was obtained from the most recently issued actuarial reports.

NOTE H: POST-EMPLOYMENT HEALTH CARE BENEFITS

In addition to the pension benefits described in Note G, the City provides post-employment health care benefits to all of its retired employees who meet eligibility requirements. Currently, the City is paying the health care premium for one (1) retiree. During the year, approximately \$11,462 was paid for post-employment health care.

The Governmental Accounting Standards Board has released Statement No. 45, Accounting and Reporting by Employers for Post-employment Benefits Other Than Pensions. This pronouncement provides guidance for local units of government in recognizing the cost of retiree health care, as well as any "other" post-employment benefits (other than pensions). The new rules will cause the government-wide financial statements to recognize the cost of providing retiree health care coverage over the working life of the new employee, rather than at the time the health care premiums are paid. This pronouncement is effective for the City of Montrose for the year ended June 30, 2010.

NOTE I: BUILDING CODE FINANCIAL INFORMATION

The City elected to report the financial activities of the building and code enforcement department in the General Fund. The following is the required information as it relates to this department for the year ended June 30, 2006:

REVENUES	
Building permits	\$ 6,419
EXPENDITURES	
Contracted services	<u>10,645</u>
EXCESS OF REVENUES (UNDER) EXPENDITURES	<u>\$ (4,226)</u>

NOTE J: FUND EQUITY RESERVES AND DESIGNATIONS

Reserved fund balance is used to earmark a portion of fund balance to indicate that it is not appropriate for expenditure or has been legally segregated for a specific future use. Designated fund equity indicates that portion of fund balance or net assets with the City has set aside for specific purposes. These reserves and designations are recorded at the fund level to indicate management plans for these funds.

City of Montrose

NOTES TO FINANCIAL STATEMENTS

June 30, 2006

NOTE J: FUND EQUITY RESERVES AND DESIGNATIONS - CONTINUED

The following are fund balance reserves as of June 30, 2006:

General Fund		
Reserved for		
Prepays	\$	42,325
Rubbish levy		<u>12,241</u>
		54,566
Special Revenue Funds		
Major Street		
Reserved for prepaids		548
Local Street		
Reserved for prepaids		<u>525</u>
		1,073
Debt Service Funds		
Downtown Development Bonds Fund		
Reserved for debt service		<u>2</u>
	\$	<u>55,641</u>

The following are fund balance designations as of June 30, 2006:

Capital Project Funds		
Capital Projects Fund		
Designated for capital expenditures	\$	163,039
Downtown Development Projects Fund		
Designated for capital expenditures		<u>339,101</u>
	\$	<u>502,140</u>

NOTE K: RESTRICTED NET ASSETS

PRIMARY GOVERNMENT		
Governmental Activities		
Restricted for streets		
Major Street	\$	214,610
Local Street		<u>113,291</u>
	\$	<u>327,901</u>
Restricted for capital projects	\$	<u>502,140</u>
Business-type Activities		
Restricted for debt service		
Water System	\$	<u>66,752</u>
Restricted for water assessment		
Water System	\$	<u>3,640</u>

NOTES TO FINANCIAL STATEMENTS

June 30, 2006

NOTE L: CONTRACTUAL COMMITMENTS

The City has entered into a contract for the Alley Infrastructure Improvements & Train Depot Site Plan - 2006 Project. The amount of the contractual commitment outstanding as of June 30, 2006 is \$459,586 for which the City will use Downtown Development bond proceeds and net assets from the Water System and Sewer System Funds to cover this commitment.

REQUIRED SUPPLEMENTARY INFORMATION

City of Montrose

General Fund

BUDGETARY COMPARISON SCHEDULE

Year Ended June 30, 2006

	Budgeted Amounts			Variance with Final Budget Positive (Negative)
	Original	Final	Actual	
REVENUES				
Taxes				
Property taxes	\$ 389,288	\$ 389,288	\$ 376,236	\$ (13,052)
Fees in lieu of taxes	14,000	14,000	18,206	4,206
Penalties and interest	4,100	4,726	8,504	3,778
Administration fees	11,000	11,000	12,303	1,303
	-	-	-	-
Total taxes	418,388	419,014	415,249	(3,765)
Licenses and permits				
Cable television license	11,800	12,066	12,066	-0-
City licenses and permits	15,800	10,100	8,335	(1,765)
Total licenses and permits	27,600	22,166	20,401	(1,765)
Intergovernmental				
State - sales tax	190,035	190,035	191,875	1,840
Charges for services				
Solid waste	51,948	51,948	51,859	(89)
Administration charges	95,000	95,000	95,000	-0-
Other	420	388	230	(158)
Total charges for services	147,368	147,336	147,089	(247)
Fines and forfeits				
Parking	8,500	8,500	6,988	(1,512)
Interest and rents				
Interest	3,400	3,800	4,205	405
Rents	46,076	36,076	31,444	(4,632)
Total interest and rents	49,476	39,876	35,649	(4,227)
Other	20,000	17,628	17,677	49
TOTAL REVENUES	861,367	844,555	834,928	(9,627)
EXPENDITURES				
General government				
Legislative	41,510	40,765	39,877	888
City Manager	80,990	78,744	77,089	1,655

City of Montrose

General Fund

BUDGETARY COMPARISON SCHEDULE - CONTINUED

Year Ended June 30, 2006

	Budgeted Amounts		Actual	Variance with Final Budget Positive (Negative)
	Original	Final		
EXPENDITURES - CONTINUED				
General government - continued				
Elections	\$ -	\$ 327	\$ 327	\$ -0-
Assessor	9,700	9,711	9,250	461
Clerk	98,458	87,685	85,282	2,403
Board of Review	661	617	517	100
Treasurer	71,667	71,937	70,590	1,347
City Hall and grounds	61,818	51,573	50,286	1,287
Other	7,500	7,500	7,500	-0-
Total general government	372,304	348,859	340,718	8,141
Public safety				
Police services	215,317	219,857	219,856	1
Fire services	48,535	43,945	43,945	-0-
Building and code enforcement	9,000	10,700	10,645	55
Total public safety	272,852	274,502	274,446	56
Public works				
Department of public works	26,675	30,803	29,968	835
Street lighting	21,500	22,000	21,902	98
Sanitation	51,948	49,948	49,236	712
Total public works	100,123	102,751	101,106	1,645
Community and economic development	3,661	3,461	3,288	173
Recreation and cultural				
Senior citizens center	1,600	1,400	1,245	155
Parks and recreation	18,765	15,265	14,520	745
Library	2,700	3,950	3,948	2
Total recreation and cultural	23,065	20,615	19,713	902

City of Montrose

General Fund

BUDGETARY COMPARISON SCHEDULE - CONTINUED

Year Ended June 30, 2006

	Budgeted Amounts			Variance with Final Budget Positive (Negative)
	Original	Final	Actual	
EXPENDITURES - CONTINUED				
Debt service				
Principal	\$ 23,286	\$ 23,286	\$ 23,396	\$ (110)
Interest	3,277	3,277	3,277	-
Total debt service	26,563	26,563	26,673	(110)
TOTAL EXPENDITURES	798,568	776,751	765,944	10,807
EXCESS OF REVENUES OVER EXPENDITURES	62,799	67,804	68,984	1,180
OTHER FINANCING SOURCES (USES)				
Bond proceeds	-	405,000	-	(405,000)
Transfer out	(65,677)	(470,645)	(65,644)	405,001
OTHER FINANCING SOURCES (USES)	(65,677)	(65,645)	(65,644)	1
NET CHANGE IN FUND BALANCE	(2,878)	2,159	3,340	1,181
Fund balance, beginning of year	198,985	198,985	198,985	-0-
Fund balance, end of year	\$ 196,107	\$ 201,144	\$ 202,325	\$ 1,181

City of Montrose

Local Street Fund

BUDGETARY COMPARISON SCHEDULE

Year Ended June 30, 2006

	<u>Budgets</u>			Variance with Final Budget Positive (Negative)
	<u>Original</u>	<u>Final</u>	<u>Actual</u>	
REVENUES				
Intergovernmental	\$ 28,000	\$ 26,000	\$ 29,173	\$ 3,173
Interest and rents	1,000	1,000	699	(301)
Other	20,920	54,603	57,915	3,312
TOTAL REVENUES	49,920	81,603	87,787	6,184
EXPENDITURES				
Current				
Public Works	69,888	65,288	44,103	21,185
EXCESS OF REVENUES OVER (UNDER) EXPENDITURES	(19,968)	16,315	43,684	27,369
OTHER FINANCING SOURCES				
Transfer in	20,000	19,433	19,433	-0-
NET CHANGE IN FUND BALANCE	32	35,748	63,117	27,369
Fund balance, beginning of year	50,174	50,174	50,174	-0-
Fund Balance, end of year	<u>\$ 50,206</u>	<u>\$ 85,922</u>	<u>\$ 113,291</u>	<u>\$ 27,369</u>

OTHER SUPPLEMENTARY INFORMATION

City of Montrose
Nonmajor Governmental Funds
COMBINING BALANCE SHEET
June 30, 2006

	Special Revenue		Debt
	Major Street	Depot Fund	Non-Voted Bonds
ASSETS			
Cash and cash equivalents	\$ 203,667	\$ 17,345	\$ -
Receivables			
Accounts	12,835	-	-
Special assessments	14,535	-	-
Prepays	548	-	-
TOTAL ASSETS	\$ 231,585	\$ 17,345	\$ -0-
LIABILITIES AND FUND BALANCES			
LIABILITIES			
Accounts payable	\$ 2,220	\$ 183	\$ -
Accrued liabilities	220	-	-
Deferred revenue	14,535	-	-
TOTAL LIABILITIES	16,975	183	-0-
FUND BALANCES			
Reserved for prepaids	548	-	-
Reserved for debt service	-	-	-
Unreserved			
Undesignated, reported in			
Special Revenue Funds	214,062	17,162	-
TOTAL FUND BALANCES	214,610	17,162	-0-
TOTAL LIABILITIES AND FUND BALANCES	\$ 231,585	\$ 17,345	\$ -0-

<u>Service Downtown Development Bonds</u>	<u>Total Nonmajor Governmental Funds</u>
\$ 2,134	\$ 223,146
-	12,835
-	14,535
-	548
<u>\$ 2,134</u>	<u>\$ 251,064</u>
\$ -	\$ 2,403
2,132	2,352
-	14,535
<u>2,132</u>	<u>19,290</u>
-	548
2	2
-	231,224
<u>2</u>	<u>231,774</u>
<u>\$ 2,134</u>	<u>\$ 251,064</u>

City of Montrose

Nonmajor Governmental Funds

COMBINING STATEMENT OF REVENUES, EXPENDITURES,
AND CHANGES IN FUND BALANCES

Year Ended June 30, 2006

	Special Revenue		Debt
	Major Street	Depot Fund	Non-Voted Bonds
REVENUES			
Intergovernmental	\$ 87,075	\$ 15,000	\$ -
Interest and rents	3,771	114	6
Other	10,222	3,932	-
TOTAL REVENUES	101,068	19,046	6
EXPENDITURES			
Current			
Public works	45,913	-	-
Community and economic development	-	10,352	-
Debt Service			
Principal	-	-	35,000
Interest	-	-	32,728
Capital outlay	-	-	-
TOTAL EXPENDITURES	45,913	10,352	67,728
EXCESS OF REVENUES OVER (UNDER) EXPENDITURES	55,155	8,694	(67,722)
OTHER FINANCING SOURCES (USES)			
Transfers in	-	-	65,644
Transfers out	(19,433)	-	-
TOTAL OTHER FINANCING SOURCES (USES)	(19,433)	-0-	65,644
NET CHANGE IN FUND BALANCES	35,722	8,694	(2,078)
Fund balances, beginning of year	178,888	8,468	2,078
Fund balances, end of year	\$ 214,610	\$ 17,162	\$ -0-

<u>Service</u> <u>Downtown</u> <u>Development</u> <u>Bonds</u>	<u>Total</u> <u>Nonmajor</u> <u>Governmental</u> <u>Funds</u>
\$ -	\$ 102,075
2	3,893
-	14,154
2	120,122
-	45,913
-	10,352
-	35,000
-	32,728
-	-
-0-	123,993
2	(3,871)
-	65,644
-	(19,433)
-0-	46,211
2	42,340
-	189,434
<u>\$ 2</u>	<u>\$ 231,774</u>

City of Montrose

Component Unit Fund

GOVERNMENTAL FUND BALANCE SHEET

June 30, 2006

	Special Revenue
	<u>Downtown Development Authority</u>
ASSETS	
Cash	<u>\$ 67,980</u>
LIABILITIES AND FUND BALANCE	
LIABILITIES	
Accounts payable	\$ 11,219
FUND BALANCE	
Unreserved - undesignated	<u>56,761</u>
TOTAL LIABILITIES AND FUND BALANCE	<u>\$ 67,980</u>

City of Montrose

Component Unit Fund

RECONCILIATION OF THE GOVERNMENTAL FUND BALANCE SHEET
TO THE STATEMENT OF NET ASSETS - DOWNTOWN DEVELOPMENT AUTHORITY

June 30, 2006

Fund balance - governmental fund \$ 56,761

Amounts reported for the governmental activities in the statement of net assets are different because:

Capital assets used in governmental activities are not financial resources
and therefore are not reported as assets in the governmental funds.

The cost of capital assets is	\$ 136,223
Accumulated depreciation is	<u>(19,644)</u>

Capital assets, net	<u>116,579</u>
---------------------	----------------

Net assets of governmental activities	<u><u>\$ 173,340</u></u>
--	--------------------------

City of Montrose

Component Unit Fund

STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE

Year Ended June 30, 2006

	Special Revenue
	Downtown Development Authority
REVENUES	
Taxes	\$ 60,329
Interest	999
TOTAL REVENUES	61,328
EXPENDITURES	
Current	
Community and economic development	71,380
EXCESS OF REVENUES (UNDER) EXPENDITURES	(10,052)
Fund balance, beginning of year	66,813
Fund balance, end of year	\$ 56,761

City of Montrose

Component Unit Fund

RECONCILIATION OF THE STATEMENT OF REVENUES,
EXPENDITURES, AND CHANGES IN FUND BALANCE OF THE GOVERNMENTAL
FUND TO THE STATEMENT OF ACTIVITIES - DOWNTOWN DEVELOPMENT AUTHORITY

Year Ended June 30, 2006

Net change in fund balance - governmental fund	\$ (10,052)
---	--------------------

Amounts reported for governmental activities in the statement of activities are different because:

Capital outlays are reported as expenditures in governmental funds. However, in the statement of activities, the cost of capital assets is allocated over their estimated useful lives as depreciation expense. In the current period, these amounts are:

Depreciation expense	<u>(9,822)</u>
----------------------	----------------

Change in net assets of governmental activities	<u><u>\$ (19,874)</u></u>
--	----------------------------------